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December 9, 2008

Mr. Scott N. Kivel
200 Kentucky Street, Suite C
Petaluma, CA 94952

Dear Mr. Kivel:

Thank you for taking the time to submit comments relating to the proposed regulatory action by CalPERS regarding determination of employee status. This letter is in response to the comments you submitted to CalPERS in your letter dated November 18, 2008. Each of your comments related to the proposed regulations, as we understand them, will be restated below, followed by CalPERS staff's responses.

Your comments include some discussion of a pending administrative case in which you represent various respondents, that to date has not been heard by the CalPERS Board of Administration (Board). [1] We will not comment on the facts or allegations relating to that pending litigation in this response.

Comment 1. The proposed regulations ". . .misread the law and will potentially eliminate CalPERS eligibility for hundreds, if not thousands, of classified employees of County Superintendents of Schools who engage in regional and/or statewide service delivery in furtherance of California public education."[2]

Response to Comment 1. CalPERS staff disagrees with your comment.

The proposed regulations require that the term employee be determined using the common law test for employment. They clarify, interpret and apply the Public Employees' Retirement Law (PERL), the applicable case law and the Board's Precedential Decisions setting forth the applicable criteria of the common law test for employment.

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[1] Your letter indicates that you represent the 58 County Superintendents of Schools in a pending administrative appeal challenging the denial of service credit to some 21 individuals. We note that that litigation is pending before Judge Lew and an administrative hearing on the matter is scheduled to begin January 29, 2009. While your comments reveal your belief that the outcome of that pending litigation might be somehow affected by adoption of the proposed regulations, CalPERS staff disagrees, contending that the regulations do no more than clarify the existing law and CalPERS' longstanding application of the law.

[2] The contention rests on your bare assertion that large numbers of individuals currently being reported as CalPERS members will be excluded from membership eligibility as a result of these regulations. CalPERS staff disagrees with this assertion. No specific examples were provided to substantiate the assertion. It should be noted that the facts that might substantiate your prediction are currently the subject of litigation and cannot be decided in the regulation process.

The proposed regulations will not eliminate CalPERS membership eligibility for CalPERS participating employers' common law employees. To the extent individuals are not the common law employees of CalPERS employers, they will have been reported to CalPERS in error. Where CalPERS discovers such errors in membership reporting, corrective action is taken on a case-by-case basis. If ultimately a determination is made that an individual fails to qualify for CalPERS membership under the common law employment test, then service credit must be backed out and member contributions must be refunded.

The regulations are necessary because under the Internal Revenue Code, assets of our plan must be held for the "exclusive benefit" of the participating employer's employees and their beneficiaries in order to preserve the plan's tax-qualified status. CalPERS cannot knowingly provide retirement benefits to individuals who are not employees under the common law test of employment.

The regulations are authorized because Government Code section 20125 provides that the Board shall determine who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system. The California Supreme Court in its 2004 *Cargill* decision determined that the PERL incorporated the common law test of employment and referred to the factors identified in the California Supreme Court decision *Tieberg v. Unemployment Ins. App. Bd.*[3]

Although the Court in *Cargill* referenced the common law test for employment to provide CalPERS pension benefits to common law employees of Metropolitan Water District, CalPERS has also used the same test to determine employee status and eligibility and/or to deny eligibility for pension benefits to any persons who are not the common law employees of a CalPERS employer. The Board recently discussed this in a Precedential Decision stating: "as the California Supreme Court held in *Metropolitan Water District v. Superior Court* (2004) 32 Cal.4th 491, 509 (*Cargill*), when determining whether individuals are employees of a public agency, CalPERS must apply the common law test for employment."[4] The Board adopted the proposed decision of the Administrative Law Judge upholding a CalPERS determination that the common law test for employment also may be used to deny pension benefits to any persons who are not the common law employees of the employer.

Comment 2. The proposed regulations fail to address a co-employment situation and are instead directed to distinguish between an employee and an independent contractor. The proposed regulations fail to address how to identify an "employer" where there may be a co-employment situation.

Response to Comment 2. CalPERS staff also disagrees with this comment.

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[3] See *Metropolitan Water District of Southern California v. Superior Court* (2004) 32 Cal.4th 491 (also referred to as "*Cargill*") and *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal.3d 943 (also referred to as "*Tieberg*").

[4] *In the Matter of the Application to Contract with CalPERS by Galt Services Authority,* Precedential Decision No. 08-01, 2008) (*Galt Services Authority*).

CalPERS staff notes that Comment 2 raises concern about the proposed regulations' alleged failure to address how to identify who is an "employer" in a situation where "co-employment" exists. The fact that an individual may be co-employed or jointly-employed under a statutory scheme other than the PERL is not relevant to the issue of whether that individual providing services to a CalPERS employer qualifies as an employee of that employer under the PERL.

The proposed regulations ensure that only the common law employees of an employer who has contracted to participate in the plan (regardless of whether that employer also has established a co-employment relationship with another employer for purposes other than the PERL) are reported into membership.[5]

The Board has referred to the common law test for employment factors in two Precedential Decisions when examining questions relating to employee status.[6] Conversely, the Board has never issued a Precedential Decision recognizing "co-employment" as a basis for CalPERS membership eligibility.

You reference two "decisions" to support your contention that the proposed regulations are deficient because they fail to address a situation where two employers may jointly exercise control over one employee. First, you discuss a prior CalPERS decision[7] which discussed co-employment; however, that decision was not designated as Precedential by the Board, so it is limited to its own specific facts and has no binding effect on the Board as to future matters. Furthermore, although the decision may have lacked clarity in its drafting, the quoted language cited in your comment actually lends support to the proposed regulations---that is, the entity that contracted with CalPERS was ultimately found to be the common law employer of the employees who were reported into CalPERS membership, and as such, the employees of that employer were found to be eligible for membership. Moreover, that decision made no definite finding on the issue of co-employment, only noting that one entity (SCLS) "might" be viewed as a co-employer.

Second, you discuss a pending case between your clients and the Board that you are currently litigating in which there has been no hearing for fact finding purposes and no proposed decision issued by the Administrative Law Judge. Your comment quotes from a pre-hearing ruling of the Administrative Law Judge which specifically provides that "*without determining the merits of such argument* [for a co-employment exception], . . . Respondents should be entitled to raise it at the time of the hearing." (Italics added.) This statement is nothing more than a preliminary order to allow an argument to be made

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[5] This is consistent with the Court's discussion of this issue in *Cargill, supra,* 32 Cal.4th at p. 506.

[6] See *In the Matter of the Application for CalPERS Membership Credit by Lee Neidengard v. Tri-Counties Association for the Developmentally Disabled*, Precedential Case No. 05-01 and *Galt Services Authority, supra*, Precedential Decision No. 08-01.

[7] *In Re the Matter of Sonoma County Office of Education, Santa Rosa Junior College District, College Legal Services of California, Henry, Shumway and Sisneros*, CalPERS Case Nos. N2004080538, N2004080539, N2004120064.

at the future hearing. The case has not come before the Board and therefore the passage cited cannot possibly demonstrate any finding by the Board.

Comment 3. The proposed regulations cite to only one Supreme Court decision and impermissibly modify the common law standard adopted as California law by the Supreme Court.

Response to Comment 3. CalPERS staff also disagrees with this comment. The proposed regulations cite to two California Supreme Court decisions. Both the *Cargill* and *Tieberg* cases are referenced in the proposed regulations and in the Initial Statement of Reasons. The proposed regulations incorporate the applicable common law factors discussed in these Supreme Court cases and in the Board's Precedential Decisions that are necessary to make an employee determination for purposes of the PERL.

CalPERS considered the language used in the *Cargill* and *Tieberg* cases when drafting the proposed regulations. Section 578.1, subdivision (b) provides:

> The most important factor in determining employee status is the right of the entity seeking to have the services performed to control the manner and means of accomplishing the result desired, regardless of whether that right is exercised with respect to all details.

CalPERS staff also disagrees that the regulation changes the meaning of the "control" factor. Subdivision (b) is consistent with language recognized by the Supreme Court in both cases cited above which provides:

> In determining whether one who performs services for another is an employee or an independent contractor, the most important factor is the right to control the manner and means of accomplishing the result desired. If the employer has the authority to exercise complete control, whether or not that right is exercised with respect to all details, an employer-employee relationship exists. Strong evidence in support of an employment relationship is the right to discharge at will, without cause.

CalPERS staff also disagrees with the portion of this comment that suggests the Board must recognize a discussion in a 1989 California Supreme Court case[8] relating to another proposed common law factor. That discussion was not subsequently adopted or discussed by the Supreme Court in 2004 in the majority opinion, when it specifically decided what the PERL means by "employee."[9]

Comment 4. Finally, you contend that the proposed regulations fail to recognize that "statutory employment" is provided by the PERL.

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[8] *Borello & Sons v. Department of Industrial Relations* (1989) 48 Cal.3d 341.
[9] See *Cargill, supra,* at page 501.

Response to Comment 4. CalPERS did not include in the proposed regulations any discussion of "statutory employment," because the topic is irrelevant to determining employee status and individual eligibility for CalPERS membership. The crucial inquiry under the PERL is whether an individual is the common law employee of an employer that contracts with CalPERS and that reports the individual into membership for such service. If an individual is a common law employee of an employer that contracts with CalPERS, then that employee is eligible for membership (absent a specific statutory or contract exclusion from membership). Whether the employer has the general statutory authority to hire employees is not relevant to this inquiry.

You reference a May 2006 nonprecedential decision in which you claim the Board recognizes the concept of statutory employment as an exception to the common law test for employment. The Board has not recognized the concept of statutory employment as an exception to the common law test for employment in any Precedential Decision.

We again thank you for your comments and hope this letter helps you gain a better understanding of the proposed regulations. CalPERS staff will be recommending the Board adopt the proposed regulations as drafted.

Please note that a public hearing on the proposed regulatory actions by CalPERS which was originally scheduled for December 17, 2008, will be held on December 16, 2008, during the Benefits and Program Administration Committee Meeting scheduled to begin at 8:30 a.m., in the Lincoln Plaza North Auditorium at 400 Q Street in Sacramento.

Sincerely,

Lori McGartland, Chief
Employer Services Division

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November 19, 2008

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Dear Board Members:

On behalf of the fifty-eight county superintendents of schools in California, I am providing the public comment of the California County Superintendents Educational Services Association[1] (CCSESA) for the CalPERS' regulatory proposal to add Article 6.5 – "Membership" – to Title 2 of the California Code of Regulations.

[1] CCSESA is the arm established by the 58 county superintendents of schools to design, implement and monitor regional and statewide educational programs that are under the county superintendents' jurisdiction. Each county superintendent of schools is automatically a member of CCSESA by virtue of holding his or her office; there are no other members. The organizational structure of eleven regional service areas in the state that was initially created by CCSESA has been adopted into statute by the Legislature. CCSESA as representative of the 58 County superintendents is identified in various statutes, as well.

We have the following concerns with CalPERS' proposed regulation and urge the CalPERS Benefits and Program Administration Committee and the CalPERS Board to reject the proposal, and instead, adopt a regulation that recognizes the constitutional and statutory authority of the county superintendents of schools to utilize statutorily-authorized employment relationships and practices necessary to implement educational programs in California:

- The regulation fails to acknowledge longstanding statutory and co-employment relationships of county superintendents and will restrict the ability of the county superintendents to carry out their constitutional and statutory obligations as mandated by the Education Code and other California codes and regulations.

- The narrow application of such a regulation is likely to result in the exclusion of thousands of classified school employees in good standing that were heretofore reported, as required by law, as members of CalPERS, as well as other employees of cities, counties and special districts who will not meet the tests embodied in this regulation.

- The regulation misapplies the findings of the Supreme Court case of *Cargill v. Metropolitan Water District* (2004) 32 Cal.4th 491 to craft a narrowly drafted regulation intended to exclude employees from the CalPERS system.

- The regulation purports to clarify and interpret provisions of existing law that are not well defined, but is instead vague and open to continuing subjective and selective interpretation by CalPERS staff charged with making determinations of employee status.

The proposed regulation is flawed and, if adopted, will disenfranchise hundreds of workers and classified employees who have participated for many years in good faith as members of CalPERS. For these reasons, the county superintendents of schools urge the Board to reject the proposed regulation and, instead, direct staff to draft a regulation that affirms, rather than denies, employment status and recognizes the necessity and validity of statutory and co-employment relationships to the delivery of educational services by county superintendents of schools.

County Superintendents of Schools Have Specific Constitutional and Statutory Authority Not Recognized by This Regulation

County superintendents of schools are public officials that for nearly 140 years have been designated a constitutional office pursuant to the California Constitution (See Article IX, Section 3). Each county superintendent and county board of education are commonly known as the county office of education. The position of county superintendent was established in the California State Constitution of 1879 and county offices of education are public agencies under state law. Fifty-three of the 58 county superintendents are locally elected officials, with five county superintendents appointed by local boards.

County superintendents of schools constitute the intermediate educational unit between the California Department of Education and the nearly 1,000 local school districts in California. Each county superintendent of schools is a CalPERS employer and, as required by the Government Code, reports for CalPERS membership county office of education non-certificated employees and classified employees of each school district and community college district within their jurisdiction. The Public Employees' Retirement Law ("PERL") designates county superintendents of schools as a "public agency."

We expect that any regulations adopted by CalPERS will recognize all of the forms of employment that the Legislature has sanctioned for county superintendents. To carry out their constitutional and statutory responsibilities, county superintendents of schools are authorized and in some cases required to utilize co- or joint employment and statutory employment. We are concerned that these other forms of employment will go unrecognized under CalPERS "common law control test" as proposed in this regulation.

Regional and statewide services and extensive inter-agency collaborations reflect how the Legislature has directed county superintendents to deliver educational services, develop programs and carry out monitoring and oversight responsibilities in an efficient and cost-effective manner. Because this proposed regulation conflicts with longstanding statutory requirements and responsibilities related to the delivery of educational services by county superintendents of schools, we believe that it places CalPERS' in the position of inadvertently dictating educational policy and practice through its regulatory interpretations.

The Legislature has historically provided wide statutory authority to county superintendents to employ individuals for regional and statewide services. (See Attachment A for a partial list of regional, statewide and inter-agency employment relationships engaged in by various county superintendents of schools.) In our view it is incumbent upon the CalPERS Board to fashion a regulation which harmonizes the PERL with other mandates by the Legislature.

The Proposed Regulation Will Exclude Thousands of Current Classified Employees in CalPERS

The county superintendents are at this time challenging the CalPERS staff's exclusion of employees of the county superintendents who are assigned to carry out the work of CCSESA. In the attached August 26, 2008 letter sent to most, if not all, county superintendents, CalPERS has expanded their inquiry and demanded a range of detailed information regarding individual employees of county superintendents who provide regional services and who perform services on behalf of another agency, dating back to 2004. The letter acknowledged in its opening paragraph that "[t]he California Public Employees' Retirement System (CalPERS) is currently engaged in an administrative hearing which relates to ...the eligibility of...personnel to be reported to CalPERS."

While the two questions posed in CalPERS' August 26, 2008, letter are ill-defined, if those employees who fall within the scope of the positions questioned in the letter are

determined to not meet the test proposed by this regulation, then CalPERS eligibility will be denied retroactively to thousands of existing employees. The letter questions positions employed by county superintendents who are stationed at other agencies, who provide regional services, or who perform services on behalf of other agencies such as school districts, other county superintendents, or the California Department of Education.

As the intermediate education unit in California government, county superintendents employ, under numerous Education Code statutes, hundreds of individuals who are classified employees performing their duties in positions as described above. Given that there have been no regulations adopted by CalPERS defining these various employment relationships, we are concerned that CalPERS staff are now bringing forward a proposed regulation to narrowly interpret employment relationships in an effort to reinforce their disputed decision regarding existing county superintendent employees working with CCSESA, and, in so doing, will jeopardize the CalPERS eligibility of hundreds of other employees throughout the state. Please note that the individuals involved in the legal dispute, along with their employers, have at all times deposited the required employer and employee contributions as required by the PERL.

We also note that a multitude of other public agencies may engage in co-employment relationships or regionalized services whereby they report to CalPERS employees who perform duties on behalf of another agency, or are assigned to do so. We urge the CalPERS Board to seek a full and accurate understanding of these issues prior to adopting a regulation which could impact the delivery of public services throughout California.

The Proposed Regulation Misapplies *Cargill v. Metropolitan Water District*

The proposed regulation misapplies the findings of the Supreme Court case of *Cargill v. Metropolitan Water District* (2004) 32 Cal.4th 491, by using the common law employment test applied by the court in that case to determine whether an employee should be included within the CalPERS system, to now by regulation apply that test as the basis for excluding employees from the CalPERS system.

CalPERS staff have frequently stated that the Supreme Court case of *Cargill v. Metropolitan Water District* confirmed that CalPERS' use of a common law control test is the exclusive means for determining service credit eligibility. However, that case involved leased employees; it did not address the status of public employees appointed to their positions. Further, that test was applied as a means to determine whether a particular employee should be mandatorily included in CalPERS as an eligible employee. The case did not contemplate the range of employment relationships that should be eligible for CalPERS participation, nor did it specify the tests or criteria that should be used to determine the conditions under which individuals included within the system by CalPERS employers should, in fact, be excluded by CalPERS.

Finally, while citing and misapplying the decision in *Cargill v. Metropolitan Water District,* CalPERS staff's rationale for the proposed regulation fails to cite another case adopted by the CalPERS Board that recognizes employment relations of the county superintendents

that would be deemed ineligible under the application of this proposed regulation.[2] Although not adopted as precedential, these issues were addressed in the decision adopted by the Board of Administration and approved by the CalPERS Board related to employees of School and College Legal Services and the Sonoma County Office of Education.

Again, these same employment relationships are now at issue in the pending administrative appeal by the 58 county superintendents. As noted above, by "Final Determination Letter" dated March 16, 2007, CalPERS staff rejected the service credit eligibility for the statewide staff which the county superintendents have employed through one of their county superintendent members to carry out the work assigned to CCSESA. Despite all employer and employee contributions having been submitted, CalPERS staff rejected CalPERS eligibility for these approximately twenty-four individuals retroactively to July 1, 1998.

In sum, the proposed regulation fails to incorporate this Board's prior decision acknowledging that common law employment may take a different form within the well-established context of service delivery by county superintendents of schools.

The Proposed Regulation is Vague and Open to Subjective and Arbitrary Application

If a regulation is to serve its intended purpose, it must be clearly worded and accurate. However, the proposed regulation is vague and ambiguous. The proposed regulation is intended by CalPERS to make specific the criteria to be used when determining whether an individual qualifies as an employee for CalPERS' purposes. It states, in part, that:

"For the purposes of the California Public Employees' Retirement Law...CalPERS shall utilize the California common law employment test...to determine whether an individual is 'in the employ of' an entity as that phrase is used in Government Code section 20028."

The regulation goes on to cite a number of factors that are included in the regulation as the definition of California common law employment that CalPERS staff will use to determine when an individual **does not** have employee status, and therefore is not eligible for membership. While the factors are illustrative of various conditions of employment, the regulation provides no guidance on how those factors would be applied in the process of excluding the CalPERS eligibility of a particular individual nor what evidence would be necessary to demonstrate that the factors have been met for an employee to assure eligibility for membership in the system.

As a result, the regulation as drafted would appear to support the existing practice of CalPERS' staff in making after-the-fact determinations of eligibility and, based on their assessment, retroactively disallowing membership for any employee even if they contributed in good faith to the system. We believe that the regulation as drafted will not sufficiently clarify employee membership status and will lead to continued subjective and

[2] Respondents Sonoma County Office of Education, Santa Rosa Junior College District, School and College Legal Services of California, Henry, Shumway and Sisneros, CalPERS Case Nos. 6359, 6359B, 6424, 6501; Office of Administrative Hearings Case Nos. N2004080538, N2004080539, N2004120064.

arbitrary interpretation by CalPERS staff. Further, the proposed regulation would likely put in jeopardy hundreds of county superintendent employees.

Conclusion

As CalPERS employer members who have historically implemented legislative mandates to provide regional, statewide and inter-agency services in an efficient and fiscally prudent manner, it is our firm belief that the proposed regulation would undercut these mandates and the efficacy of the programs engaged in by county superintendents of schools. We believe that the proposed regulation as drafted 1) ignores the forms of well-settled employment relationships mentioned previously, 2) is far too narrow in its purported definition of common law employment, and 3) fails to preclude subjective and arbitrary application of the regulatory rules to particular employment relationships.

The California county superintendents ask that the Board reject the proposed regulation and direct staff to draft a regulation that supports the range of legitimate employment relationships that county superintendents historically and currently use to carry out their duties.

Sincerely,

Julian D. Crocker

Dr. Julian Crocker, President
California County Superintendents Educational Services Association (CCSESA) and
San Luis Obispo County Superintendent of Schools

Attachments:
A. Illustrative Programs Operated by County Superintendents
B. August 26, 2008 letter from Ronald Gow to County Superintendents

Cc w/attachments:
County Superintendents of Schools
Kenneth Marzion, Interim Executive Officer
Lori McGartland, Chief, Employer Services Division
Peter Mixon, General Counsel
Wesley Kennedy, Senior Staff Counsel
Ronald Gow, Compensation Review Unit, Employer Services Division
Joe Parilo, Acting Regulations Coordinator
Julia Brownley, Chair, Assembly Committee on Education
Ed Hernandez, Chair, Assembly Committee on Public Employees, Retirement and Social Security
Jack Scott, Chair, Senate Committee on Education
Patricia Wiggins, Chair, Senate Committee on Public Employment & Retirement